

# **REPORT OF THE AUDITOR-GENERAL TO THE MEMBERS OF THE COUNCIL ON THE FINANCIAL STATEMENTS OF THE MAMUSA LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2006**

## **1. AUDIT ASSIGNMENT**

The financial statements as set out on pages      to      , for the year ended 30 June 2006, have been audited in terms of section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996), read with sections 4 and 20 of the Public Audit Act, 2004 (Act No. 25 of 2004) and section 126 of the Public Finance Management Act, 2003 (Act no 56 of 2003) (MFMA). These financial statements are the responsibility of the Municipal Manager. My responsibility is to express an opinion on these financial statements, based on the audit.

## **2. NATURE AND SCOPE**

The audit was conducted in accordance with the International Standards on Auditing read with General Notice 1512 of 2006, issued in Government Gazette no. 29326 of 27 October 2006. Those standards require that I plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement.

An audit includes:

- examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements,
- assessing the accounting principles used and significant estimates made by management, and
- evaluating the overall financial statement presentation.

Furthermore, an audit includes an examination, on a test basis, of evidence supporting compliance in all material respects with the relevant laws and regulations, which came to my attention and are applicable to financial matters.

I believe that the audit provides a reasonable basis for my opinion.

## **3. BASIS OF ACCOUNTING**

The municipality's policy is to prepare the financial statements on the entity specific basis of accounting as described in paragraph 1.1 of the accounting policies to the financial statements.

## **4. QUALIFICATION**

### **4.1 Opening balances**

As reported in the prior year a disclaimer of audit opinion was issued. During the year under review no corrective measures were implemented by management on qualifications reported and as a result I was unable to verify the opening balances other than agreeing them to the prior year financial statements.

### **4.2 Fixed Assets**

4.2.1 I am unable to express an opinion on the existence of fixed assets as the municipality did not perform a complete stock take of fixed assets during the year under review. The fixed asset register also does not have any reference numbers to facilitate the identification of fixed assets.

4.2.2 Furthermore no supporting documentation could be provided to confirm the authorisation of fixed asset additions amounting to R371 599.

### **4.3 Debtors**

4.3.1 The debtors balance amounting to R49 929 130 as disclosed in note 10 to the financial statements is understated with the value-added tax (VAT) on the debtors amounting to R3 514 030.

4.3.2 In the absence of an accounting policy to establish an appropriate provision for bad debts, I am unable to express an opinion on the adequacy of the provision amounting to R16 221 234 as disclosed in note 10 to the financial statements. Based on the fact that consumer debtors include amounts of R49 617 034 (inclusive of VAT) which are debtors older than 90 days as well as Ipeleng debtors amounting to R43 728 659 which are doubtful, the provision for bad debts could be materially understated.

4.3.3 The recoverability of long outstanding sundry debtors amounting to R396 444 included under current debtors in note 10 to the financial statements could not be assessed.

4.3.4 Consumer deposits amounting to R477 083 as disclosed in note 5 to the financial statements is insufficient to cover the outstanding debtors amounting to R49 929 130 (excluding VAT) as disclosed in note 10 to the financial statements.

#### **4.4 Creditors**

Creditors could not be verified as correctly stated due to the following:

4.4.1 No adequate supporting documentation including creditors' reconciliations could be presented for the trade creditors amounting to R10 136 922 in note 13 to the financial statements. Further unrecorded creditors amounting to R6 790 118, with the corresponding expenses, were not raised. Unrecorded sundry creditors amounting to R49 591 also existed.

4.4.2 Creditors were overstated with amounts received in advance amounting to R17 435 145 as reflected in note 13. Trust funds are therefore understated with this amount.

4.4.3 Creditors in the financial statements are understated by the VAT provision amounting to R22 363 which represents the net position between the VAT not provided for on both the debtors balance and the provision for bad debts.

4.4.4 Only R103 299 of an outstanding debt of R520 473 due to Bophirima District Council was disclosed. This debt was subsequently to year-end written off by Bophirima District Council.

#### **4.5 Provision for leave pay**

In the absence of proper leave records, I am unable to express an opinion on the adequacy of the provision for leave pay amounting to R1 462 465 as reflected in note 12 to the financial statements.

#### **4.6 Long-term liabilities**

The short-term portion of long-term liabilities was understated by R240 553 which was incorrectly included under trade creditors. The trade creditors balance is therefore overstated by this amount.

#### **4.7 Irregular expenditure**

Irregular expenditure amounting to R827 389 was incurred during the year due to non-compliance with the supply chain management process. The amount is not disclosed in the financial statements.

#### **4.8 Going concern**

Given the uncertainty regarding the recoverability of debtors mentioned in paragraph 4.3 and the fact that:

- Funds amounting to R9 774 469 were not represented by cash or investments;

- On various occasions VAT and PAYE were not timeously paid over to SARS;
  - loans were not repaid in accordance with the conditions of the loans;
  - significant creditors were outstanding; and
  - doubtful debts amounting to R30 703 436 had not been provided for,
- future liquidity constraints may result in the municipality being unable to realise its assets and discharge its liabilities in the normal course of business. This casts serious doubt on the ability of the municipality to continue as a going concern. This fact is disclosed in paragraph 3 of the report of the Treasurer.

#### **4.9 Journal entries**

No supporting documentation could be provided for journal entries amounting to R16 107 077.

#### **4.10 Capital commitments**

No supporting documentation could be provided for the amount of R33 190 086 disclosed as capital commitments included in note 27 to the financial statements.

### **5. DISCLAIMER OF AUDIT OPINION**

Because of the significance of the matters referred to in paragraph 4, I do not express an opinion on the financial statements.

### **6. EMPHASIS OF MATTER**

Without further qualifying the audit opinion, attention is drawn to the following matters:

#### **6.1 Financial statements: presentation and disclosure**

##### **6.1.1 Balance sheet and associated notes**

- Contrary to the Institute for Municipal Finance Officers (IMFO) requirement, Appendix F was not attached to the financial statements of the municipality.
- Contrary to IMFO requirements, expenditure amounting to R8 780 463 disclosed in Appendix A for the Housing Fund have been set off against other income and not disclosed as operating expenditure.

#### **6.2 Fruitless and wasteful expenditure**

Fruitless and wasteful expenditure amounting to R106 054 in respect of penalties and interest paid due to the late submission of VAT returns have not been disclosed as fruitless and wasteful expenditure in the financial statements.

### **6.3 Weaknesses in internal control**

The following are some of the more material weaknesses found during the audit:

- Key positions in the finance department are vacant. No proper segregation of duties is therefore, in place, resulting in an inadequate internal control environment. Furthermore overtime in excess of 30% of monthly salaries have been paid.
- A number of employees did not take a minimum of 10 days leave per annum.
- Two employees earning in excess of R30 000 per annum rented municipal houses.
- Not all policies and procedures are in place. A risk management policy and overtime policy has not been implemented at the municipality. The municipality has also not implemented a fraud prevention plan.
- No controls are in place to identify related party transactions.
- No supporting documentation could be provided for audit purposes regarding the authorisation of withdrawals from the investments accounts. No supporting documentation could be provided for the list of indigent debtors received.

### **6.4 Non-compliances with laws and regulations**

6.4.1 The following non-compliance with the VAT Act and Income Tax Act, 1962 (Act No. 58 of 1962) occurred:

- Contrary to paragraph 13 and 14(3) of the Fourth Schedule, the municipality did not furnish the reconciliation statement showing details of the total amount of employees' tax deducted or withheld as well as the details of IRP5 certificates issued during the tax year.
- Contrary to the Basic Conditions of Employment Act, 1995 (Act No. 95 of 1995), as amended, the municipality did not make payment to the pension fund, medical aid and UIF before the 7<sup>th</sup> of a month.
- Contrary to Sections 3, 6 and 7 of the Skill Development, 1999 (Act No. 9 of 1999), skills development levies for the year were not paid by the 7<sup>th</sup> of the month and were not budgeted for.

6.4.2 The following non-compliance with the Municipal Systems Act, 2000 (Act No. 32 of 2000) occurred:

- Section 57(1)(b) - No annual performance evaluation for the municipal manager and all senior managers was done for the year under review.

- Section 66 and 67 - The HR policies and procedures were not implemented in accordance with applicable laws particularly the monitoring, measuring and evaluating of performance of staff.
- Section 97 and 98 - A credit control and debt collection policy exists but is not being implemented by the municipality.
- Schedule 1, section 5 - Of the twelve councillors, only half have complied with the terms of the act in completing the forms regarding the disclosure of their interests.
- Contrary to section 70 the municipal manager did not provide a copy of the Code of Conduct contained in Schedule 2 to every member of the staff of the municipality.

#### 6.4.3 The following non-compliance with the MFMA occurred:

- Contrary to section 64(4) funds collected on behalf of a third party was not paid over,
- Contrary to section 66 the accounting officer did not report to the council on all expenditure incurred by the municipality on staff salaries, wages, allowances and benefits, in a manner which disclosed such expenditure by type of expenditure.
- Contrary to section 11(4) the accounting officer did not table in the municipal council a consolidated report of all withdrawals (payments) and submit a copy of the report to the provincial department responsible for local government in the province and to the Auditor-General.
- Contrary to section 52(d) the mayor did not submit a report to the council on the implementation of the budget and the financial state of affairs of the municipality.
- Contrary to section 64(1) and (2) the credit control and debt collection policy exists but is not implemented by the municipality.
- Contrary to section 69(1) the accounting officer in demonstrating responsibility for implementing the municipality's budget, did not take all reasonable steps to ensure that the spending of funds was in accordance with the budget and that expenditure was properly monitored.
- Contrary to Section 70(2) the municipality exceeded the net overdrawn position for a period in excess of the prescribed period. No correspondence

between the Municipality and the National Treasury relating to the overdraft could be obtained.

6.4.4 The following non-compliance with the Supply Chain Regulations occurred:

- A report was not submitted for the year under review by the accounting officer to the council on the implementation of the Supply Chain Management policy.
- The municipality has not yet established a Supply Chain Management Unit.
- The municipality did not implement controls to ensure that at least 3 written quotations were obtained for all purchases above R2 000.
- A list of accredited prospective providers of goods and services, compiled per commodity and per type of service could not be provided.
- Proof that the public was invited for competitive bids for certain tenders could not be provided.
- Contract agreements to confirm compliance with Supply Chain Management requirements for certain contracts could not be provided.
- A declaration of independence made by providers for all awards above R2 000 received from the municipality could not be submitted.

6.4.5 The following non-compliance with the Housing Act, 1997 (Act No. 107 of 1997) occurred:

- Contrary to section 10(4), the municipal manager failed to submit detailed statements, signed by such manager, showing the results of the previous year's transactions, and the balance sheets in respect of the separate accounts to the accounting officer of the provincial housing fund within the prescribed time frame.
- The municipality did not maintain a separate account into which the moneys transferred was deposited, and out of which all disbursements in connection with the administration of the national housing programme in question was made.

6.4.6 The following non-compliance with the Public Office Bearers Act, 1998 (Act No. 20 of 1998) occurred:

- No council resolution was taken concerning the councillors' increment, pension fund and medical aid fund contributions as stipulated in Government Gazette no 1125 dated 14 November 2005.

## **6.5 Computer Information Systems review**

Proper Information Technology (IT) governance structures were not in place which includes policies and procedures, defined IT processes, proper IT strategic plan and staffing to support and properly monitor the IT functions.

## **7. APPRECIATION**

The assistance rendered by the staff of Mamusa Local Municipality during the audit is sincerely appreciated.

A.J. Grobler for Auditor-General

Rustenburg

30/11/ 2006



A U D I T O R - G E N E R A L